

the West Brom

# Condensed consolidated half-yearly financial information

30 September 2013



# Chief Executive's Business Review

Jonathan Westhoff



## Performance

The West Brom once again delivered an improvement in financial performance and upheld its commitment to members by offering a competitive range of savings, investment and mortgage products, coupled with excellent customer service.

In the six months to 30 September 2013, the Society reported an operating profit of £6.0m (30 September 2012: loss of £0.5m) and reduced its loss before tax by 22% to £5.2m (30 September 2012: £6.7m). The Core Tier 1 capital ratio further increased to 14.5% (31 March 2013: 14.1%) confirming the Society's underlying financial strength and the value derived from its balance sheet de-risking programme.

The net interest margin improved to 0.67% (30 September 2012: 0.42%). Although total funding costs remained significantly above their long-run norm, relative to Bank Rate, there was some improvement as a consequence of the slow down in competition for retail funds and the Society's successful completion of a second residential mortgage backed securitisation programme. Encouragingly, there are also signs of increased residential mortgage lending activity and an upward trend in UK house prices. The Society has benefited from these house price movements through its subsidiary, West Bromwich Homes Limited, a residential investment company, which recorded a £2.0m revaluation gain on its property portfolio during the period.

Such positive market sentiment has not translated to the commercial property sector which has experienced another challenging six months. Commercial impairment charges for the half year to 30 September 2013 were £10.0m (30 September 2012: £2.8m), partially offset by £3.7m fair value gains on financial instruments held to economically hedge the impaired loans. The Society remains steadfast in its efforts to reduce the commercial loan book, with balances down 7% to £1.0bn (31 March 2013: £1.1bn). Funds set aside for potential losses on commercial mortgages equate to 7.3% of the current loan book (31 March 2013: 5.7%), with appropriate provisions made wherever factors indicating impairment are identified.

The number of residential mortgages in arrears by more than three months at 30 September 2013 stabilised at 1.92% (31 March 2013: 1.92%). This represents a very encouraging performance given the high levels of unemployment, a contracting mortgage book and a forbearance strategy aligned to the principles of responsible lending. The Society actively seeks to support those borrowers experiencing genuine financial hardship, enabling them to remain in their homes where this is believed to be in their best interests (i.e. where the loss to

the customer is not expected to increase over time). Strict credit criteria are in place for all new lending and the quality of the existing prime residential and buy-to-let portfolios remains strong.

Management expenses for the six months to 30 September 2013 were just 1% higher than the first half of 2012/13. Notwithstanding a focus on cost efficiency, the Society recognises the importance of creating an infrastructure to facilitate growth. To this end, we have begun an investment in larger, modern head office premises, due for completion in Spring 2015, and have developed systems which enhance further our mortgage lending capability. During the period, the Society repositioned itself in the mortgage market, expanding the range of market leading products available to new and existing borrowers through branch, direct and intermediary channels. This essential investment in the future, together with additional costs of regulation, and a contracting asset base, contributed to an increased management expenses ratio of 0.75%, compared with 0.66% for the year ended 31 March 2013.

## Funding

As a traditional building society, the West Brom is primarily funded by retail deposits. The intense competition for retail savings abated during the period, as lenders were able to access lower cost funding through Government supported schemes and other cheaper sources of wholesale funding. The Society has continued to offer competitive rates to savers and, at 30 September 2013, 81.3% of total shares and borrowings were in the form of retail savings products.

While the wholesale markets are a secondary source of funding compared with retail deposits, some diversification in the funding base is beneficial from a risk management perspective. In May 2013, the Society was successful in raising £380m of cost-effective, long-term secured wholesale funding via a residential mortgage backed securitisation transaction.

The improvement in high funding costs resulted in a net interest margin of 0.67%, up from 0.42% for six months ended 30 September 2012. Interest receivable, however, remains constrained by the low returns on high quality treasury assets, held for liquidity purposes, and the substantial proportion of mortgage loans linked to Bank Rate.

## Liquidity

The Society maintains its prudent approach to liquidity management, holding only securities rated single A or better in its treasury asset portfolio. The West Brom has no direct exposure to any Eurozone sovereign, investing solely in UK and supranational sovereign securities. There were no impairment charges against any treasury investment assets during the period.

The Society's liquidity ratio increased modestly to 20.2% at 30 September 2013 (31 March 2013: 19.8%), remaining comfortably in excess of internal and regulatory limits.

The Group's liquidity portfolio is analysed below:

	30 Sep 13		30 Sep 12		31 Mar 13	
	£m	%	£m	%	£m	%
Buffer liquidity						
Bank of England Reserve	193.0	20.3	309.9	23.3	384.5	37.0
Supranationals	200.1	21.1	384.9	28.9	198.9	19.2
<b>Total buffer liquidity</b>	<b>393.1</b>	<b>41.4</b>	694.8	52.2	583.4	56.2
Other securities – rated single A or better	357.4	37.6	434.8	32.6	300.6	28.9
Subsidiary/other liquidity	199.1	21.0	201.9	15.2	154.9	14.9
<b>Total liquidity</b>	<b>949.6</b>	<b>100.0</b>	1,331.5	100.0	1,038.9	100.0

## Capital

Capital is held as the ultimate protection for depositors. The Board sets the internal level of capital required in order to exceed minimum regulatory requirements.

The following table shows the composition of regulatory capital and the capital ratios for the last three reporting periods:

	30 Sep 13 £m	30 Sep 12 £m	31 Mar 13 £m
<b>Regulatory capital</b>			
<b>Tier 1</b>			
General reserves	233.4	237.3	236.1
Permanent interest bearing shares (note 1)	74.9	74.9	74.9
Profit participating deferred shares	172.8	173.7	173.7
Intangible assets (note 2)	(7.5)	(6.9)	(7.9)
Deductions from Tier 1 capital (note 3)	(5.9)	(4.5)	(3.7)
	<b>467.7</b>	474.5	473.1
<b>Tier 2</b>			
Revaluation reserve	3.7	3.7	3.7
Collective impairment allowance	16.0	18.9	15.1
Contingency against collective provision add back (note 4)	(9.2)	(7.5)	(8.3)
Deductions from Tier 2 capital (note 3)	(0.2)	(1.8)	(0.1)
	<b>10.3</b>	13.3	10.4
<b>Total capital</b>	<b>478.0</b>	487.8	483.5
<b>Risk weighted assets – Pillar 1</b>			
Retail mortgages	1,506.5	1,614.0	1,577.9
Commercial loans	809.5	925.4	888.4
Treasury assets	156.2	136.9	114.4
Other assets	156.5	160.5	157.0
Market risk	9.6	10.4	9.5
Operational risk	73.3	70.0	70.0
	<b>2,711.6</b>	2,917.2	2,817.2
<b>Key capital ratios (note 5)</b>	<b>%</b>	%	%
Core Tier 1 ratio	14.5	13.7	14.1
Tier 1 ratio	17.2	16.3	16.8
Solvency ratio	17.6	16.7	17.2

### Notes

1. Permanent interest bearing shares include any adjustments for unamortised premiums and discounts.
2. Intangible assets are deducted from general reserves in arriving at capital for regulatory purposes.
3. Certain deductions from capital are required to be allocated, 50% to Tier 1 and 50% to Tier 2 capital. Other deductions are Tier specific.
4. Deduction from the collective provision add back, reflecting the proportion of the provision that is disallowable for capital purposes.
5. Calculated as relevant capital divided by risk weighted assets. Core Tier 1 represents Tier 1 capital excluding permanent interest bearing shares.

The West Brom has established a robust capital position which compares favourably with peers in the UK bank and building society sectors. The Society's Core Tier 1 ratio, a key measure of financial resilience, improved again to 14.5% (31 March 2013: 14.1%) as a result of the planned contraction in risk weighted assets, down 4% in the last six months to £2.7bn.

## Principal risks and uncertainties

Effective management of risks and opportunities is essential to achieving the Society's strategic objectives. The Society aims to manage effectively all of the risks that arise from its activities and believes that its approach to risk management reflects an understanding of actual and potential risk exposures, the quantification of the impact of such exposures and the development and implementation of appropriate controls to manage these exposures within the Society's agreed risk appetite.

The Society's activities are governed by its constitution, principles and values. The Directors have also agreed a set of statements which describe the Board's risk appetite in terms of a number of key risk categories: business, credit, capital, liquidity, market, operational, retail conduct and pension liability. These Risk Appetite Statements drive corporate planning activity, including capital and liquidity planning, as well as providing the basis for key risk measures.

The principal risks and uncertainties which could impact the Society's long-term performance remain those outlined on pages 17 to 20 of the Annual Report and Accounts for the year ended 31 March 2013. There have been no significant changes in the Society's approach to risk management in the six months ended 30 September 2013.

## Outlook

The UK has experienced three successive quarters of growth and the housing market is gathering momentum. The UK recovery is, however, still in its early stages with high levels of unemployment, suppressed wages and challenges in the Eurozone and beyond giving uncertainty as to whether economic growth is sustainable. Market commentators have expressed concern over the continuation of recent house price rises, particularly in and around London. The West Brom will continue with its responsible lending policies and prudent approach to capital and liquidity management, such that it has the financial resources to withstand any reversal in the UK domestic recovery. While the underlying credit quality of the Society's residential mortgages is strong, the commercial portfolio is more vulnerable to changing economic conditions and further provisioning for potential losses is likely.

The downward trend in retail funding costs has contributed to an improvement in net interest margin, although interest receipts continue to be constrained by the Society's exposure to the effects of the low interest rate environment and escalating competition in the mortgage markets. Notwithstanding the Monetary Policy Committee's forward guidance, intended to provide some clarity on the trajectory of interest rates, market opinion on the quantum and timing of a rise in Bank Rate varies widely. To maintain support for its saving members, through this extended market disruption, the Group has sought to mitigate the impact of adverse market conditions by increasing the interest income from its non-consumer buy-to-let portfolio with effect from 1 December 2013.

A key development in the regulatory arena has been the separation, in April 2013, of the Financial Services Authority into prudential and conduct counterparts – the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) respectively. The PRA has an objective to promote the safety and soundness of firms while the FCA seeks to protect and enhance confidence in the UK financial system, making markets work well so that consumers get a fair deal.

The Capital Requirements Directive (CRD) IV package has now been finalised and comes into force on 1 January 2014. CRD IV transposes the new global standards on bank capital (commonly known as the Basel III agreement) into the EU legal framework. Another significant regulatory reform is the Mortgage Market Review (MMR) which aims to deliver a mortgage market that works better for consumers and is sustainable for all participants. The Society is constantly monitoring regulatory developments and is therefore well placed to respond appropriately to regulatory change.

The financial services industry faces increased regulatory and public scrutiny in the wake of PPI mis-selling and, more recently, LIBOR fixing scandals. As a traditional, regional building society, the West Brom is run for the benefit of its members and is committed to acting with integrity in all of its dealings with them. We are confident in our ability to safeguard customer deposits and clear in our priorities to provide quality mortgage, savings and investment products and exceptional customer service.

**Jonathan Westhoff**  
Chief Executive

### Forward looking statements

*Certain statements in this half-year report are forward looking. Although the West Brom believes that the expectations reflected in these forward looking statements are reasonable, we can give no assurance that these expectations will prove to be an accurate reflection of actual results. By their nature, all forward looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of the West Brom. As a result, the West Brom's actual future financial condition, business performance and results may differ materially from the plans, goals and expectations expressed or implied in these forward looking statements. Due to such risks and uncertainties the West Brom cautions readers not to place undue reliance on such forward looking statements. We undertake no obligation to update any forward looking statements whether as a result of new information, future events or otherwise.*

## Condensed consolidated half-yearly income statement

for the six months ended 30 September 2013

	6 months ended 30 Sep 13 unaudited £m	6 months ended 30 Sep 12 unaudited £m	Year ended 31 Mar 13 audited £m
Interest receivable and similar income	67.8	84.9	161.1
Interest expense and similar charges	(47.3)	(70.1)	(127.4)
<b>Net interest receivable</b>	<b>20.5</b>	14.8	33.7
Fees and commissions receivable	2.5	2.1	5.6
Other operating income	1.8	3.2	4.3
<b>Total operating income</b>	<b>24.8</b>	20.1	43.6
Fair value gains/(losses) on financial instruments	3.8	(1.0)	(1.7)
Net realised profits	0.1	2.8	7.3
<b>Total income</b>	<b>28.7</b>	21.9	49.2
Administrative expenses	(20.4)	(20.1)	(39.3)
Depreciation and amortisation	(2.3)	(2.3)	(5.6)
<b>Operating profit/(loss) before impairments, provisions and revaluation gains/(losses)</b>	<b>6.0</b>	(0.5)	4.3
Gains/(Losses) on investment properties	2.0	-	(0.2)
Impairment losses on loans and advances	(11.8)	(4.6)	(10.8)
Provisions for liabilities – FSCS levy	(1.4)	(1.7)	(2.7)
Provisions for liabilities – other	-	0.1	-
<b>Loss before tax</b>	<b>(5.2)</b>	(6.7)	(9.4)
Taxation	1.6	1.6	4.4
<b>Loss for the period</b>	<b>(3.6)</b>	(5.1)	(5.0)

## Condensed consolidated half-yearly statement of comprehensive income

for the six months ended 30 September 2013

	6 months ended 30 Sep 13 unaudited £m	6 months ended 30 Sep 12 unaudited £m	Year ended 31 Mar 13 audited £m
<b>Loss for the period</b>	<b>(3.6)</b>	(5.1)	(5.0)
<b>Other comprehensive income</b>			
<b>Items that may be subsequently reclassified to profit or loss</b>			
Available for sale investments:			
Valuation (loss)/gain taken to equity	(4.1)	12.8	15.6
Amounts transferred to income statement	(0.1)	(2.0)	(4.8)
Cash flow hedge losses taken to equity	(0.5)	-	-
Taxation	1.1	(2.6)	(2.6)
<b>Items that will not be subsequently reclassified to profit or loss</b>			
Actuarial loss on retirement benefit obligations	-	-	(1.7)
Taxation	-	-	0.4
<b>Other comprehensive income for the period, net of tax</b>	<b>(3.6)</b>	8.2	6.9
<b>Total comprehensive income for the period</b>	<b>(7.2)</b>	3.1	1.9
<b>As a percentage of mean total assets</b>	<b>%</b>	%	%
Loss for the period	(0.06)	(0.07)	(0.07)
Management expenses (annualised)	0.75	0.63	0.66

## Condensed consolidated half-yearly statement of financial position

at 30 September 2013

	Notes	30 Sep 13 unaudited £m	30 Sep 12 unaudited £m	31 Mar 13 audited £m
<b>Assets</b>				
Cash and balances with the Bank of England		203.7	318.5	392.3
Loans and advances to credit institutions		188.4	193.3	147.1
Investment securities		557.5	819.7	499.5
Derivative financial instruments		29.3	50.8	29.5
Loans and advances to customers	7	4,805.6	5,165.4	4,971.1
Deferred tax assets		26.8	27.4	24.0
Trade and other receivables		3.0	5.6	2.8
Intangible assets	9	7.5	6.9	7.9
Investment properties	10	113.6	112.7	112.5
Property, plant and equipment	9	16.9	17.4	16.5
Retirement benefit assets		2.7	0.4	0.4
<b>Total assets</b>		<b>5,955.0</b>	6,718.1	6,203.6
<b>Liabilities</b>				
Shares	8	4,369.1	5,283.0	4,652.2
Amounts due to credit institutions		15.7	31.1	28.5
Amounts due to other customers		134.9	168.3	193.0
Derivative financial instruments		72.8	120.7	99.4
Debt securities in issue	11	855.1	583.5	709.1
Deferred tax liabilities		4.3	8.2	4.3
Trade and other payables		8.7	18.3	12.5
Provisions for liabilities	6	3.8	6.0	6.8
<b>Total liabilities</b>		<b>5,464.4</b>	6,219.1	5,705.8
<b>Equity</b>				
Profit participating deferred shares	12	172.8	173.7	173.7
Subscribed capital	14	74.9	74.9	74.9
General reserves		233.4	237.3	236.1
Revaluation reserve		3.7	3.7	3.7
Available for sale reserve		6.2	9.4	9.4
Cash flow hedging reserve		(0.4)	-	-
<b>Total equity attributable to members</b>		<b>490.6</b>	499.0	497.8
<b>Total liabilities and equity</b>		<b>5,955.0</b>	6,718.1	6,203.6
<b>As a percentage of shares and borrowings</b>				
		%	%	%
Gross capital		10.4	8.8	9.5
Free capital		7.8	6.7	7.2
Total liquidity		20.2	23.4	19.8

## Condensed consolidated statement of changes in members' interest

### 6 months ended 30 September 2013 (unaudited)

	Profit participating deferred shares	Subscribed capital	General reserves	Revaluation reserve	Available for sale reserve	Cash flow hedging reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 April 2013	173.7	74.9	236.1	3.7	9.4	-	497.8
Comprehensive income for the period	(0.9)	-	(2.7)	-	(3.2)	(0.4)	(7.2)
At 30 September 2013	172.8	74.9	233.4	3.7	6.2	(0.4)	490.6

### 6 months ended 30 September 2012 (unaudited)

	Profit participating deferred shares	Subscribed capital	General reserves	Revaluation reserve	Available for sale reserve	Cash flow hedging reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 April 2012	175.0	74.9	241.1	3.7	1.2	-	495.9
Comprehensive income for the period	(1.3)	-	(3.8)	-	8.2	-	3.1
At 30 September 2012	173.7	74.9	237.3	3.7	9.4	-	499.0

### Year ended 31 March 2013 (audited)

	Profit participating deferred shares	Subscribed capital	General reserves	Revaluation reserve	Available for sale reserve	Cash flow hedging reserve	Total
	£m	£m	£m	£m	£m	£m	£m
At 1 April 2012	175.0	74.9	241.1	3.7	1.2	-	495.9
Comprehensive income for the period	(1.3)	-	(5.0)	-	8.2	-	1.9
At 31 March 2013	173.7	74.9	236.1	3.7	9.4	-	497.8

Under the terms of the profit participating deferred shares (PPDS), 25% of the annual post-tax profits or losses are allocated against the PPDS reserve.

## Condensed consolidated half-yearly statement of cash flows

for the six months ended 30 September 2013

	6 months ended 30 Sep 13 unaudited £m	6 months ended 30 Sep 12 unaudited* £m	Year ended 31 Mar 13 audited £m
<b>Net cash flows from operating activities (overleaf)</b>	<b>(235.4)</b>	(113.1)	(566.8)
<b>Cash flows from investing activities</b>			
Purchase of investment securities	<b>(58.0)</b>	(575.3)	(672.1)
Proceeds from disposal of investment securities	<b>55.4</b>	591.2	870.7
Proceeds from disposal of investment properties	<b>0.9</b>	-	-
Purchase of property, plant and equipment	<b>(2.6)</b>	(1.9)	(5.0)
Proceeds from disposal of property, plant and equipment	<b>0.4</b>	0.2	0.2
<b>Net cash flows from investing activities</b>	<b>(3.9)</b>	14.2	193.8
<b>Cash flows from financing activities</b>			
Issue of mortgage backed loan notes	<b>380.0</b>	175.0	175.0
Repayment of mortgage backed loan notes	<b>(30.6)</b>	(23.0)	(67.3)
Net repayment of other debt securities	<b>(199.4)</b>	(516.9)	(318.2)
<b>Net cash flows from financing activities</b>	<b>150.0</b>	(364.9)	(210.5)
Net decrease in cash	<b>(89.3)</b>	(463.8)	(583.5)
Cash and cash equivalents at beginning of period	<b>550.3</b>	1,133.8	1,133.8
<b>Cash and cash equivalents at end of period</b>	<b>461.0</b>	670.0	550.3

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than 90 days maturity:

	30 Sep 13 unaudited £m	30 Sep 12 unaudited* £m	31 Mar 13 audited £m
<b>Cash and cash equivalents</b>			
Cash in hand (including Bank of England Reserve account)	<b>195.3</b>	318.5	386.8
Loans and advances to credit institutions	<b>188.4</b>	193.2	147.0
Investment securities	<b>77.3</b>	158.3	16.5
	<b>461.0</b>	670.0	550.3

The Group is required to maintain certain mandatory balances with the Bank of England which, at 30 September 2013, amounted to £8.4m (30 September 2012: £5.7m and 31 March 2013: £5.5m). The movement in these balances is included within cash flows from operating activities.

## Condensed consolidated half-yearly statement of cash flows (continued)

for the six months ended 30 September 2013

	6 months ended 30 Sep 13 unaudited £m	6 months ended 30 Sep 12 unaudited* £m	Year ended 31 Mar 13 audited £m
<b>Cash flows from operating activities</b>			
Loss on ordinary activities before tax from continuing activities	(5.2)	(6.7)	(9.4)
Movement in prepayments and accrued income	(0.5)	(1.1)	0.9
Movement in accruals and deferred income	(3.3)	(1.4)	(3.6)
Impairment losses on loans and advances	11.8	4.6	10.8
Depreciation and amortisation	2.3	2.3	5.6
Disposal of fixed assets and investment properties	(0.1)	-	-
Revaluation of investment properties	(2.0)	-	0.2
Movement in provisions for liabilities	(3.0)	(0.4)	0.4
Movement in derivative financial instruments	(26.4)	26.6	26.6
Movement in fair value adjustments	22.6	(7.4)	(11.8)
Change in retirement benefit obligations	(2.3)	(0.8)	(2.5)
<b>Cash flows from operating activities before changes in operating assets and liabilities</b>	<b>(6.1)</b>	15.7	17.2
Movement in loans and advances to customers	125.6	211.7	387.5
Movement in loans and advances to credit institutions	(2.8)	1.3	1.3
Movement in shares	(281.0)	(383.5)	(1,009.5)
Movement in deposits and other borrowings	(70.9)	42.1	40.2
Movement in trade and other receivables	0.3	(0.2)	0.5
Movement in trade and other payables	(0.5)	(0.2)	(4.0)
<b>Net cash outflow from operating activities</b>	<b>(235.4)</b>	(113.1)	(566.8)

\* The condensed consolidated half-yearly statement of cash flows for the six months ended 30 September 2012 has been represented to reflect the current year categorisation, providing a more detailed analysis of cash flows within each section.

# Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2013

## 1. General information

These half-yearly financial results do not constitute statutory accounts as defined in section 81A of the Building Societies Act 1986. A copy of the statutory accounts for the year to 31 March 2013 has been delivered to the Financial Conduct Authority and the relevant information in this report has been extracted from these statutory accounts. These accounts have been reported on by the Group's auditors and the report of the auditors was (i) unqualified, and (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report.

The consolidated half-yearly financial information for the six months to 30 September 2013 and 30 September 2012 is unaudited and has not been reviewed by the Group's auditors.

## 2. Basis of preparation

This condensed consolidated half-yearly financial report for the half-year ended 30 September 2013 has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and with IAS 34, 'Interim financial reporting' as adopted by the European Union. The half-yearly condensed consolidated financial report should be read in conjunction with the Annual Report and Accounts for the year ended 31 March 2013, which have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

## 3. Accounting policies

The accounting policies adopted by the Group in the preparation of its 2013/14 half-yearly financial report and those which the Group currently expects to adopt in its Annual Report and Accounts for the year ended 31 March 2014 are consistent with those disclosed in the Annual Report and Accounts for the year ended 31 March 2013, except for the adoption of new or amended accounting standards described below.

The following new or amended accounting standards, which are relevant to the Group, have been adopted during the six months ended 30 September 2013:

- *Amendments to IAS 1, 'Presentation of Financial Statements' – Presentation of Items of Other Comprehensive Income*

The amendments require separate presentation within the statement of comprehensive income of items that will potentially be reclassified to profit or loss in subsequent periods and items that will never be reclassified to profit or loss.

The statement of comprehensive income has been updated to meet the requirements of the amended standard with comparative items represented accordingly.

- *IAS 19 (revised 2011), 'Employee Benefits'*

The revised standard updates the recognition, presentation and disclosure requirements for retirement benefit plans.

For the six months ended 30 September 2013, operating income is £0.2m lower than it would have been prior to the adoption of the revised IAS 19. This difference arises on replacing the interest cost on scheme liabilities and expected return on scheme assets with a single interest income on the net retirement benefit asset, calculated using the discount rate assumption.

If the revised standard had applied in the prior year, other operating income would have been £0.2m and £0.4m lower at 30 September 2012 and 31 March 2013 respectively, with an equivalent increase in other comprehensive income. The comparative figures in the income statement and statement of comprehensive income have not been restated for the adoption of IAS 19 (revised 2011) as the impact on the Society's results would be insignificant. There would be no impact on the Group's net assets or reserves as a consequence of retrospectively applying the revised IAS 19.

- *IFRS 13, 'Fair Value Measurement'*

The new standard defines fair value and provides a single framework for measuring fair value, replacing existing IFRS guidance in this area.

The application of IFRS 13 has not had a significant financial impact on these condensed financial statements. The additional disclosures required by the new standard, and incorporated into IAS 34, are provided in note 15.

- *Amendments to IFRS 7, 'Financial Instruments: Disclosures' – Disclosures – Offsetting Financial Assets and Financial Liabilities*

The amendments require new disclosures for financial instruments which are offset in the statement of financial position.

The application of the amendments has had no impact on these condensed financial statements.

# Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2013

## 4. Business segments

Operating segments are reported in accordance with the internal reporting provided to the Group Board (the chief operating decision maker), which is responsible for allocating resources to the reportable segments and assessing their performance.

The Group has three main business segments:

- Retail – incorporating residential lending, savings, investments and protection;
- Commercial – primarily representing loans for commercial property investment; and
- Property – a portfolio of residential properties for rent.

Central Group operations have been included in Retail and comprise risk management, funding, treasury services, human resources and computer services, none of which constitute a separately reportable segment.

There were no changes to reportable segments during the period.

Transactions between the business segments are carried out at arm's length. The revenue from external parties reported to the Group Board is measured in a manner consistent with that in the consolidated income statement.

Funds are ordinarily allocated between segments, resulting in funding cost transfers disclosed in inter-segment net interest income. Interest charged for these funds is based on the Group's cost of capital. Central administrative costs are also allocated between segments and are disclosed in inter-segment administrative expenses. There are no other material items of income or expense between the business segments.

The Group does not consider its operations to be cyclical or seasonal in nature.

### 6 months ended 30 September 2013 (unaudited)

	Retail	Commercial	Property	Eliminations	Total Group
	£m	£m	£m	£m	£m
<b>Income</b>					
Interest receivable and similar income	67.2	12.2	-	(11.6)	<b>67.8</b>
Interest expense and similar charges	(43.2)	(14.2)	(1.6)	11.7	<b>(47.3)</b>
<b>Net interest receivable/(expense)</b>	<b>24.0</b>	<b>(2.0)</b>	<b>(1.6)</b>	<b>0.1</b>	<b>20.5</b>
Fees and commissions receivable	2.3	0.2	-	-	<b>2.5</b>
Other operating (expense)/income	(0.1)	1.1	1.9	(1.1)	<b>1.8</b>
<b>Total operating income</b>	<b>26.2</b>	<b>(0.7)</b>	<b>0.3</b>	<b>(1.0)</b>	<b>24.8</b>
Fair value gains on financial instruments	0.2	3.6	-	-	<b>3.8</b>
Net realised profits	0.1	-	-	-	<b>0.1</b>
<b>Total income</b>	<b>26.5</b>	<b>2.9</b>	<b>0.3</b>	<b>(1.0)</b>	<b>28.7</b>
Administrative expenses	(18.8)	(1.5)	(0.1)	-	<b>(20.4)</b>
Depreciation and amortisation	(2.3)	-	-	-	<b>(2.3)</b>
<b>Operating profit before impairments, provisions and revaluation gains</b>	<b>5.4</b>	<b>1.4</b>	<b>0.2</b>	<b>(1.0)</b>	<b>6.0</b>
Gains on investment properties	-	-	2.0	-	<b>2.0</b>
Impairment losses on loans and advances	(1.8)	(10.0)	-	-	<b>(11.8)</b>
Provisions for liabilities – FSCS levy	(1.4)	-	-	-	<b>(1.4)</b>
<b>Profit/(Loss) before tax</b>	<b>2.2</b>	<b>(8.6)</b>	<b>2.2</b>	<b>(1.0)</b>	<b>(5.2)</b>
<b>Total assets</b>	<b>5,828.6</b>	<b>931.5</b>	<b>117.8</b>	<b>(922.9)</b>	<b>5,955.0</b>
<b>Total liabilities</b>	<b>5,288.7</b>	<b>1,006.9</b>	<b>94.5</b>	<b>(925.7)</b>	<b>5,464.4</b>
<b>Capital expenditure</b>	<b>2.6</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2.6</b>

# Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2013

## 4. Business segments (continued)

6 months ended 30 September 2012 (unaudited)					
	Retail	Commercial	Property	Eliminations	Total Group
	£m	£m	£m	£m	£m
Income					
Interest receivable and similar income	83.1	25.3	-	(23.5)	84.9
Interest expense and similar charges	(67.7)	(24.3)	(1.6)	23.5	(70.1)
Net interest receivable/(expense)	15.4	1.0	(1.6)	-	14.8
Fees and commissions receivable	2.1	-	-	-	2.1
Other operating income	0.5	0.9	2.0	(0.2)	3.2
Total operating income	18.0	1.9	0.4	(0.2)	20.1
Fair value losses on financial instruments	(1.0)	-	-	-	(1.0)
Net realised profits	2.8	-	-	-	2.8
Total income	19.8	1.9	0.4	(0.2)	21.9
Administrative expenses	(18.5)	(1.8)	-	0.2	(20.1)
Depreciation and amortisation	(2.3)	-	-	-	(2.3)
Operating (loss)/profit before impairments and provisions	(1.0)	0.1	0.4	-	(0.5)
Impairment losses on loans and advances	(1.8)	(2.8)	-	-	(4.6)
Provisions for liabilities – FSCS levy	(1.7)	-	-	-	(1.7)
Provisions for liabilities – other	0.1	-	-	-	0.1
(Loss)/Profit before tax	(4.4)	(2.7)	0.4	-	(6.7)
Total assets	6,431.8	1,069.7	113.7	(897.1)	6,718.1
Total liabilities	5,912.4	1,112.9	92.7	(898.9)	6,219.1
Capital expenditure	1.7	-	-	-	1.7

# Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2013

## 4. Business segments (continued)

Year ended 31 March 2013 (audited)					
	Retail	Commercial	Property	Eliminations	Total Group
	£m	£m	£m	£m	£m
Income					
Interest receivable and similar income	165.9	28.8	-	(33.6)	161.1
Interest expense and similar charges	(124.1)	(33.6)	(3.2)	33.5	(127.4)
Net interest receivable/(expense)	41.8	(4.8)	(3.2)	(0.1)	33.7
Fees and commissions receivable	5.5	0.1	-	-	5.6
Other operating income	0.3	-	4.0	-	4.3
Total operating income/(expense)	47.6	(4.7)	0.8	(0.1)	43.6
Fair value losses on financial instruments	(1.7)	-	-	-	(1.7)
Net realised profits	7.3	-	-	-	7.3
Total income/(expense)	53.2	(4.7)	0.8	(0.1)	49.2
Administrative expenses	(36.7)	(2.9)	(0.1)	0.4	(39.3)
Depreciation and amortisation	(5.6)	-	-	-	(5.6)
Operating profit/(loss) before impairments, provisions and revaluation losses	10.9	(7.6)	0.7	0.3	4.3
Losses on investment properties	-	-	(0.2)	-	(0.2)
Impairment losses on loans and advances	(4.1)	(6.7)	-	-	(10.8)
Provisions for liabilities – FSCS levy	(2.7)	-	-	-	(2.7)
Profit/(Loss) before tax	4.1	(14.3)	0.5	0.3	(9.4)
Total assets	6,050.6	1,000.0	118.0	(965.0)	6,203.6
Total liabilities	5,508.4	1,068.7	96.4	(967.7)	5,705.8
Capital expenditure	5.1	-	-	-	5.1

## 5. Allowance for losses on loans and advances to customers

	6 months ended 30 Sep 13 unaudited £m	6 months ended 30 Sep 12 unaudited £m	Year ended 31 Mar 13 audited £m
<b>Impairment charge for the period</b>	<b>11.8</b>	4.6	10.8
<b>Impairment provision at end of period</b>			
Loans fully secured on residential property	36.1	40.7	40.3
Other loans	66.8	54.8	54.0
	<b>102.9</b>	95.5	94.3

The charge for the six months ended 30 September 2013 is partially offset by £3.7m fair value gains on financial instruments held to economically hedge impaired loans. These provisions are deducted from the appropriate asset values in the statement of financial position.

# Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2013

## 6. Provisions for liabilities

	6 months ended 30 Sep 13 (unaudited)			6 months ended 30 Sep 12 (unaudited)			Year ended 31 Mar 13 (audited)		
	FSCS	Onerous contracts	Total	FSCS	Onerous contracts	Total	FSCS	Onerous contracts	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m
At beginning of period	6.0	0.8	6.8	5.2	1.2	6.4	5.2	1.2	6.4
Utilised in the period	(4.2)	(0.2)	(4.4)	(1.9)	(0.1)	(2.0)	(1.9)	(0.4)	(2.3)
Charge/(Release) for the period	1.4	-	1.4	1.7	(0.1)	1.6	2.7	-	2.7
<b>At end of period</b>	<b>3.2</b>	<b>0.6</b>	<b>3.8</b>	5.0	1.0	6.0	6.0	0.8	6.8

### Financial Services Compensation Scheme (FSCS)

In common with all regulated UK deposit takers, the Society pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it. The FSCS levy consists of two parts: a management expenses levy and a compensation levy. The management expenses levy covers the costs of running the scheme and the compensation levy covers the amount of compensation the scheme pays, net of any recoveries it makes using the rights that have been assigned to it. During 2008 and 2009 claims were triggered against the FSCS in relation to Bradford & Bingley plc, Kaupthing Singer and Friedlander, Heritable Bank plc, Landsbanki Islands hf, London Scottish Bank plc and Dunfermline Building Society.

The FSCS meets these current claims by way of loans received from HM Treasury. The terms of these loans are interest only for the first three years, and the FSCS seeks to recover the interest cost, together with ongoing management expenses, by way of annual management levies on members over this period.

The Society FSCS provision reflects market participation up to the reporting date. £2.4m of the provision relates to the estimated management expenses levy for the scheme year 2013/14 and half the expected charge for the 2014/15 scheme year. £0.8m of the provision relates to the compensation levy. These amounts were calculated on the basis of the Society's current share of protected deposits taking into account the FSCS estimate of total management expenses for each scheme year and the current estimated shortfall on capital loans outstanding.

The provision does not include any estimate for levies for scheme years after 2014/15 which may arise.

### Onerous contracts

The provision for onerous contracts covers the loss anticipated in connection with future lease expenses from non-cancellable lease commitments in branches that the Society has, as part of its branch restructure, decided are no longer required.

# Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2013

## 7. Loans and advances to customers

	<b>30 Sep 13 unaudited £m</b>	30 Sep 12 unaudited £m	31 Mar 13 audited £m
<b>Loans and receivables</b>			
Loans fully secured on residential property	<b>3,928.1</b>	4,158.4	4,004.5
Other loans			
Loans fully secured on land	<b>915.8</b>	1,023.8	990.3
Other loans	<b>0.1</b>	0.1	0.1
	<b>4,844.0</b>	5,182.3	4,994.9
<b>At fair value through profit or loss</b>			
Other loans			
Loans fully secured on land	<b>64.5</b>	78.6	70.5
	<b>4,908.5</b>	5,260.9	5,065.4
Less: impairment provisions	<b>(102.9)</b>	(95.5)	(94.3)
	<b>4,805.6</b>	5,165.4	4,971.1

Included within loans and advances to customers are £199.9m (30 September 2012: £372.3m) of commercial mortgage balances and £1,581.9m (30 September 2012: £1,276.4m) of residential mortgage balances that the Group has sold to bankruptcy remote special purpose entities (SPEs). The SPEs have been funded by issuing mortgage backed securities (MBSs) of which loan notes totalling £1,113.9m (30 September 2012: £1,268.6m) are held by the Group.

The Group has made subordinated loans to the SPEs to provide some level of credit enhancement to the MBSs. In future periods the Group will earn interest income on the subordinated loans and fees for managing the loans. The Group will earn deferred consideration once the cash flows generated by the SPEs have been used to pay interest and capital to the holders of the MBSs. Since the Group maintains substantially all of the risks (key risk being an exposure to credit risk through the subordinated loan agreements) and rewards emanating from the mortgages, they have been retained on the Group's statement of financial position in accordance with IAS 39.

## 8. Shares

	<b>30 Sep 13 unaudited £m</b>	30 Sep 12 unaudited £m	31 Mar 13 audited £m
Held by individuals	<b>4,368.0</b>	5,281.9	4,651.1
Other shares	<b>1.1</b>	1.1	1.1
	<b>4,369.1</b>	5,283.0	4,652.2

# Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2013

## 9. Property, plant, equipment and intangible assets

### 6 months ended 30 September 2013 (unaudited)

	Tangible and intangible assets £m
Net book value at 1 April 2013	24.4
Additions	2.6
Disposals	(0.3)
Depreciation, amortisation, impairment and other movements	(2.3)
<b>Net book value at 30 September 2013</b>	<b>24.4</b>

### 6 months ended 30 September 2012 (unaudited)

	Tangible and intangible assets £m
Net book value at 1 April 2012	25.1
Additions	1.7
Disposals	(0.2)
Depreciation, amortisation, impairment and other movements	(2.3)
Net book value at 30 September 2012	24.3

### Year ended 31 March 2013 (audited)

	Tangible and intangible assets £m
Net book value at 1 April 2012	25.1
Additions	5.1
Disposals	(0.2)
Depreciation, amortisation, impairment and other movements	(5.6)
Net book value at 31 March 2013	24.4

#### Capital commitments

The Group has placed contracts amounting to a total of £0.7m (30 September 2012: £0.5m) for future expenditure that was not provided in the financial statements.

## 10. Investment properties

	6 months ended 30 Sep 13 unaudited £m	6 months ended 30 Sep 12 unaudited £m	Year ended 31 Mar 13 audited £m
<b>Valuation</b>			
At beginning of period	112.5	112.7	112.7
Disposals	(0.9)	-	-
Net gains/(losses) from fair value adjustments	2.0	-	(0.2)
<b>At end of period</b>	<b>113.6</b>	112.7	112.5

# Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2013

## 11. Debt securities in issue

	<b>30 Sep 13 unaudited</b>	30 Sep 12 unaudited	31 Mar 13 audited
	<b>£m</b>	£m	£m
GBP medium term notes	-	3.0	-
Certificates of deposit	<b>6.0</b>	2.0	4.0
Other debt securities	<b>175.4</b>	200.9	376.8
Non-recourse finance on securitised advances	<b>673.7</b>	377.6	328.3
	<b>855.1</b>	583.5	709.1

The non-recourse finance comprises mortgage backed floating rate notes (the Notes) secured over portfolios of mortgage loans secured by first charges over residential and commercial properties in the United Kingdom. Prior to redemption of the Notes on the final interest payment date, the Notes will be subject to mandatory and/or optional redemption, in certain circumstances, on each interest payment date.

## 12. Profit participating deferred shares

	<b>30 Sep 13 unaudited</b>	30 Sep 12 unaudited	31 Mar 13 audited
	<b>£m</b>	£m	£m
<b>Book value</b>			
Nominal value	<b>182.5</b>	182.5	182.5
Cumulative fair value adjustments at date of transition	<b>3.8</b>	3.8	3.8
Capitalised issue costs	<b>(2.2)</b>	(2.2)	(2.2)
	<b>184.1</b>	184.1	184.1
<b>Cumulative reserve deficit</b>			
At beginning of period	<b>(10.4)</b>	(9.1)	(9.1)
Share of loss for the period	<b>(0.9)</b>	(1.3)	(1.3)
	<b>(11.3)</b>	(10.4)	(10.4)
<b>Net value at end of period</b>	<b>172.8</b>	173.7	173.7

The profit participating deferred shares (PPDS) are entitled to receive a distribution, at the discretion of the Society, of up to 25% of the Group's post-tax profits in the future (calculated prior to payment of the PPDS dividend). No such distribution may be made if the cumulative reserves are in deficit.

# Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2013

## 13. Related party transactions

Related party transactions for the six months to 30 September 2013 are within the normal course of business and of a similar nature to those for the last financial year, full details of which are disclosed in the Annual Report and Accounts for the year ended 31 March 2013.

## 14. Subscribed capital

	<b>30 Sep 13 unaudited £m</b>	30 Sep 12 unaudited £m	31 Mar 13 audited £m
Permanent interest bearing shares	<b>74.9</b>	74.9	74.9

In a winding up or dissolution of the Society the claims of the holders of permanent interest bearing shares (PIBS) would rank behind all other creditors of the Society, with the exception of holders of profit participating deferred shares (PPDS) with which the PIBS rank pari-passu, and the claims of members holding shares as to principal and interest. The holders of PIBS are not entitled to any share in any final surplus upon winding up or dissolution of the Society.

With respect to future interest payments, as a condition of the PPDS, the Society has undertaken to pay an amount which, when annualised, represents the lower of: 6.15% of the outstanding principal amount of the PIBS and the dividend yield attributable to the PPDS with respect to the prior financial year ended 31 March whose payment is at the discretion of the Society.

## 15. Financial instruments

### Fair values of financial assets and financial liabilities

The table below compares the carrying and fair values of the Group's non-derivative financial instruments by category at the reporting date. Where available, market values have been used to determine fair values. Where market values are not available, fair values have been calculated by discounting cash flows at prevailing interest rates.

	<b>30 Sep 13 unaudited Carrying value £m</b>	<b>30 Sep 13 unaudited Fair value £m</b>
<b>Financial assets</b>		
Cash and balances with the Bank of England	<b>203.7</b>	<b>203.7</b>
Investment securities	<b>557.5</b>	<b>557.5</b>
Loans and advances to credit institutions	<b>188.4</b>	<b>188.4</b>
Loans and advances to customers	<b>4,805.6</b>	<b>4,606.9</b>
<b>Financial liabilities</b>		
Shares	<b>4,369.1</b>	<b>4,356.3</b>
Amounts due to credit institutions	<b>15.7</b>	<b>15.7</b>
Amounts due to other customers	<b>134.9</b>	<b>134.9</b>
Debt securities in issue	<b>855.1</b>	<b>833.5</b>

# Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2013

## 15. Financial instruments (continued)

### a) Loans and advances to customers

The fair value of loans and advances to customers has been calculated on an individual loan basis taking into account factors such as impairment and interest rates. It is not considered appropriate to value them collectively as a portfolio sale.

Impairment is calculated on an incurred loss basis except to the extent that acquired mortgage books have been fair valued on a basis which makes allowances for anticipated losses over the remaining life of the loans.

### b) Deposits and borrowings

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount repayable on demand.

The estimated fair value of fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

### c) Debt securities in issue

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

The fair values have been calculated on a product basis and as such do not necessarily represent the value that could have been obtained for a portfolio if it were sold at 30 September 2013.

### Fair value measurement

The following table summarises the fair value measurement basis used for assets and liabilities held on the statement of financial position at fair value:

At 30 September 2013 (unaudited)				
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>Financial assets</b>				
Investment securities	557.5	-	-	557.5
Loans and advances to customers	-	61.3	-	61.3
Derivative financial instruments	-	29.3	-	29.3
	557.5	90.6	-	648.1
<b>Financial liabilities</b>				
Debt securities in issue	-	54.5	-	54.5
Derivative financial instruments	-	72.8	-	72.8
	-	127.3	-	127.3

**Level 1:** Quoted prices (unadjusted) in active markets for identical assets or liabilities.

**Level 2:** Valuation techniques where all inputs are taken from observable market data, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

**Level 3:** Valuation techniques where significant inputs are not based on observable market data. None of the Group's financial assets or liabilities are valued using this technique.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist and other valuation models. Assumptions and market observable inputs used in valuation techniques include risk-free and benchmark interest rates, equity index prices and expected price volatilities. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm's length.

Observable prices are those that have been seen either from counterparties or from market pricing sources including Bloomberg. The use of these depends upon the liquidity of the relevant market.

# Notes to condensed consolidated half-yearly financial information for the six months ended 30 September 2013

## 16. Statement of Directors' responsibilities

The Directors confirm that this condensed set of financial statements has been prepared in accordance with IAS 34 as adopted by the European Union, and that the half-yearly management report herein includes a fair review of the information required by DTR 4.2.7R and DTR 4.2.8R.

The Directors of West Bromwich Building Society are listed in the West Bromwich Building Society Annual Report for the year ended 31 March 2013.

By order of the Board

**Jonathan Westhoff**  
Chief Executive

**Mark Gibbard**  
Group Finance Director

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